MCI Telecommunications Corporation
1801 Pennsylvania Avenue, N.W.
Washington, DC 20006
202 887 2180
Fax: 202 887 2204

Michael Hydock
Executive Staff Member
Federal Regulatory Analysis

ORIGINAL

DOCKET FILE COPY ORIGINAL

EX PARTE OR LATE FILED

May 25, 1995

RECEIVED
MAY 25 1995
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M. Street, N.W. - Room 222
Washington, D.C. 20558

Re: *Ex Parte* Letter, CC Docket No. 94-1

Dear Mr. Caton:

MCI Telecommunications Corporation (MCI) requests that you please add the following attached letter to Kathleen Wallman, Chief, Common Carrier Bureau to the record in this proceeding.

Sincerely,

Michael Hydock

Michael Hydock
Executive Staff Member
Federal Regulatory Analysis

Attachments

No. of Copies rec'd 0+1
List A B C D E

MCI Telecommunications Corporation
1801 Pennsylvania Avenue, N.W.
Washington, DC 20006
202 887 2180
Fax: 202 887 2204

Michael Hydock
Executive Staff Member
Federal Regulatory Analysis

ORIGINAL

May 25, 1995

Kathleen Wallman
Chief, Common Carrier Bureau
Federal Communications Commission
Suite 500
1919 M. Street, N.W.
Washington, DC 20554

Re: *Ex Parte* - CC Docket No. 94-1, Price Cap Performance Review for Local Exchange Carriers

Ms. Wallman:

MCI Telecommunications Corporation (MCI) is corresponding with you to raise an issue involving the application of the new services test for price cap carriers. The new services test, as applied to offerings made by local exchange carriers (LECs) that expand the choice available to consumers, gives guidance to LECs in their attempts to develop initial prices for new offerings. It is crucial that projections of demand, investment, and cost be as accurate as possible. Inaccuracies can lead to, in certain circumstances, over-recovery of costs and financial damage to ratepayers. In this particular case, MCI believes that it has been financially harmed though the application of the new services test for Line Information Database (LIDB).

LIDB tariffs were initially filed late in 1991 by all major LECs. LIDB service was filed to allow interexchange carriers (IXCs) the ability to receive calling card validation from the LECs for those customers placing an interLATA call through an IXC using a LEC-issued calling card. At the end of 1991, the Commission released an order finding that the proposed transmittals raised questions of law and fact, and issued a one day tariff suspension and accounting order (Local Exchange Carrier Line Information Database, Order, 7 FCC Rcd 525). A subsequent order designated issues for investigation that were addressed through by Direct Cases filed by the assorted LECs during 1992 (Local Exchange Carrier Line Information Database, Order Designating Issues for Investigation, CC Docket No. 92-24, 7 F.C.C. Rcd 2169 (1992)).

Late in 1992 the Common Carrier Bureau issued an information request to the LECs that were party to the investigation, asking for consistently formatted and comparable projected investment, cost, and demand information. Ultimately, in 1993, the Commission released its final order in this docket, allowing revised LIDB query rates to go into effect (Local Exchange Carrier Line Information Database, Order , CC Docket No. 92-24, 8 FCC Rcd 7130 (1993)). During the pendancy of this investigation, the Commission attempted to determine whether the carriers' costs, investments, and overhead factors were reasonable, and whether reasonable rates had been developed during the ratemaking process. Ultimately, the Commission allowed rates to go into effect that were significantly lower than those originally filed by all but two LECs.

As discussed above, the new services test can be an adequate method to derive reasonable initial rates for a new service, but only if the underlying cost support reasonably reflects actual cost and demand. Specifically the showing must include: a complete and accurate delineation of the relevant direct investment and costs that will be utilized to provide the service; an appropriate level of overhead loadings; and, an accurate estimation of the future demand levels for the new service. The first two items combine to determine the costs that must be recovered from the new service in order to allow the LEC to profitably provide the service. The demand estimate is required in order to determine a just and reasonable rate for the new service. For example, an underestimate of demand will lead to a LEC overcharging for each unit of the new service.

In the majority of cases, a new service is provisioned through capital that has a wide range of operating capacities. For example, the LEC database that provides the LIDB information, while expensive, is capable of processing extraordinarily large numbers of queries per hour. Therefore, the Commission must be vigilant to ensure that demand estimates are not artificially low, thereby creating a higher than reasonable rate. A numerical example will aid in illustrating the case. Assume the LEC has a new product that costs $1,000 to provision, and is capable of providing 100,000 transactions per year. At peak capacity, each transaction would cost $0.01. Assuming a 1.5 overhead factor, and an initial demand estimate of 100,000 transactions, this would yield a rate of $0.015 per transaction. However, if the estimate of demand was placed at 75,000 truncations, the unit cost study would yield a cost of $0.0133, and the 1.5 overhead loading factor would increase that to $0.02. What this suggests is that an underestimation of demand of 25 percent could yield initial rates that are 33 percent greater than the reasonable level. Moreover, if initially projected demand level is underestimated and the 100,000 demand level does come to pass, the LEC will recover $2,000 while the cost plus overhead rate was $1,500.

MCI raises these concerns at this time because of the apparent severe underestimate of LIDB query demand by the LECs. Attached to this letter is Table 1, which demonstrates the severity of the situation. This table illustrates the demand quantities used for ratemaking, and the actual demand quantities from 1994 base year demand. Actual LIDB demand is running 25 percent to 144 percent greater than what had been used by these RBOCs for ratemaking purposes. Such findings clearly suggest that the rates that were finally allowed to go into effect by the Commission were excessive, and still remain unreasonable. Based on these underestimates of demand, rates for LIDB queries are 25 to 100 percent too high. Following Table 1 is a graphical depiction of the relative errors between ratemaking and actual demand for each of these RBOCs.

The final chart provides a time-series analysis of the ratemaking demand as compared with the 1992, 1993, and 1994 actual query demand. This table shows two salient facts: For most RBOCs, LIDB demand has quickly grown beyond the levels that were originally forecast, and the results across the seven RBOCs suggests that some were more accurate at forecasting future demand than others. MCI is aware that the current new services rules only require a 12 month forecast of expected demand, and from that perspective, 1992 demand levels were relatively close to forecast for most of the LECs. However, once LIDB was folded into price caps during the 1993 Annual Access Filing, it should have been clear to the Commission, if it was receiving new service monitoring data at some level on a monthly basis, that LIDB demand was beginning to accelerate sharply.

The Commission, in its recently completed Price Cap Performance Review, found that price cap LECs have little influence on demand growth, and therefore should not gain added benefit from such growth (Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, First Report and Order, at ¶ 269). In this particular instance, IXC marketing efforts to gain the telecommunications business of the traveling public has led to large increases in the need for LIDB queries. Consequently, the IXCs that are driving increased demand should see some benefit from this demand growth. IXC demand growth has succeeded in increasing the amount of queries for LIDB, pushing unit cost down, and allowing LECs to operate their LIDB query databases at more efficient levels.

Several possibilities are available to the Commission to remedy this situation, and others like it. First, the Commission should require monthly demand and revenue reports from the price cap LECs for new services to ascertain whether there is a steep ramp-up in demand after the first year. If there has been such a large increase, initial rates should be reset accordingly. Second, new services that are rolled into price caps should be examined at that time to evaluate whether significant changes have occurred in the demand quantities such that cost/demand relationships are in need of adjustment. Finally, the Commission can choose to wait for carriers that have been harmed by excessive rates to file complaints with the Commission. The Commission should address this problem in its planned Future Notice in the above-captioned docket.

Based upon this analysis, MCI believes that the existing rates for LIDB queries higher than reasonable rates would be. Moreover, MCI concludes that is has incurred financial harm. based on the fact that it has been purchasing LIDB services at these unreasonable rates. At the present time, MCI is evaluating the level of overcharging that it has incurred, and is also evaluating its options to seek redress. MCI would be available to discuss these issues and findings with you, at your convenience, if you so desire. We would be willing to discuss any questions you or your staff has about the analysis contained within this letter.

Respectfully,

Michael Hydock

Michael Hydock
Executive Staff Member
Federal Regulatory Analysis

Attachments

cc: Richard Metzger
Geraldine Matise
David A. Nall

Table 1

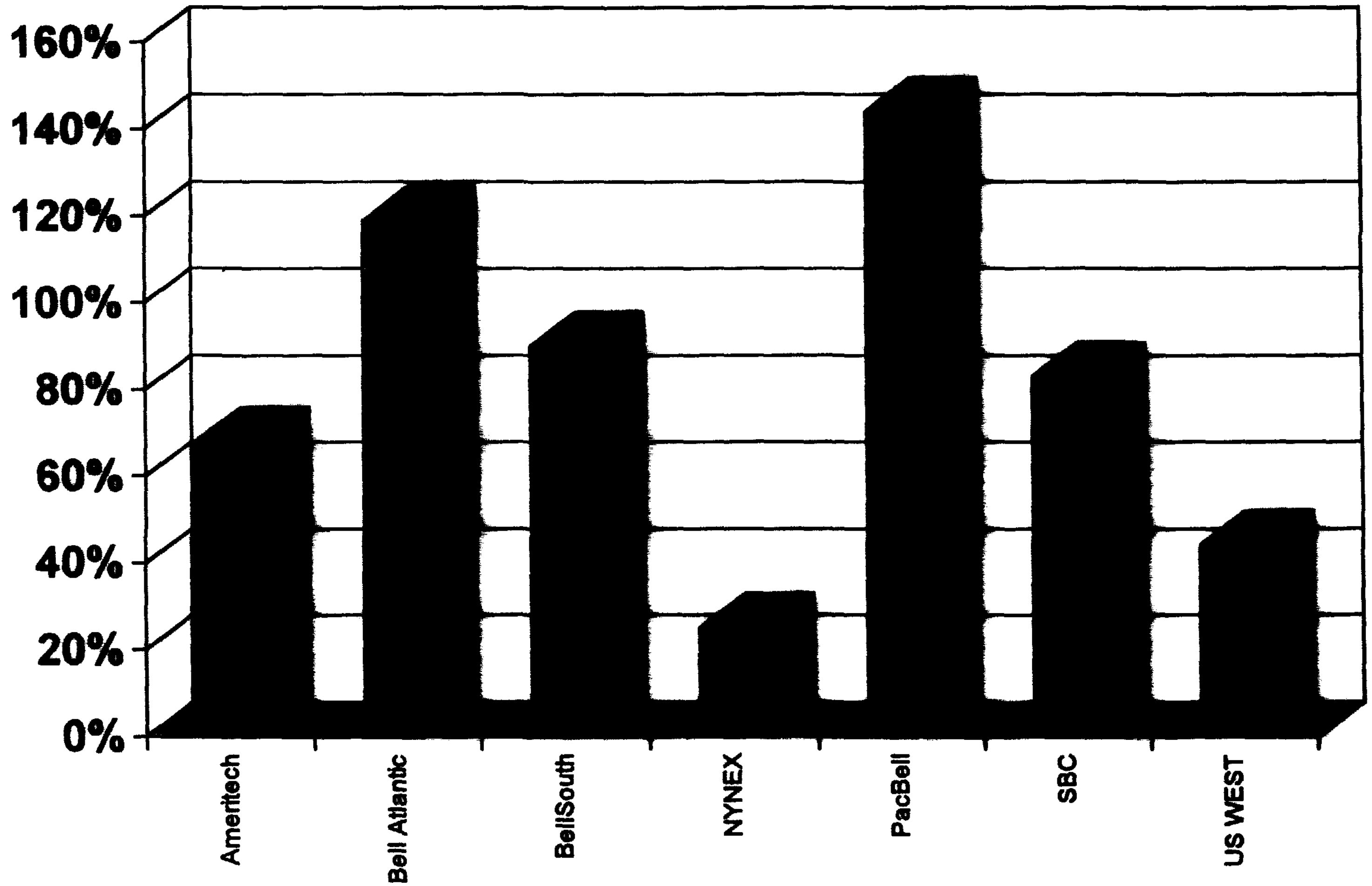
LIDB Validation Queries

(Millions of Queries)

	Ratemaking Demand	1994 Demand	% Difference
Ameritech	200.70	337.98	68%
Bell Atlantic	76.70	168.11	119%
BellSouth	210.90	400.49	90%
NYNEX	200.00	250.41	25%
PacBell	100.07	244.57	144%
SBC	138.60	253.92	83%
US WEST	165.45	238.96	44%

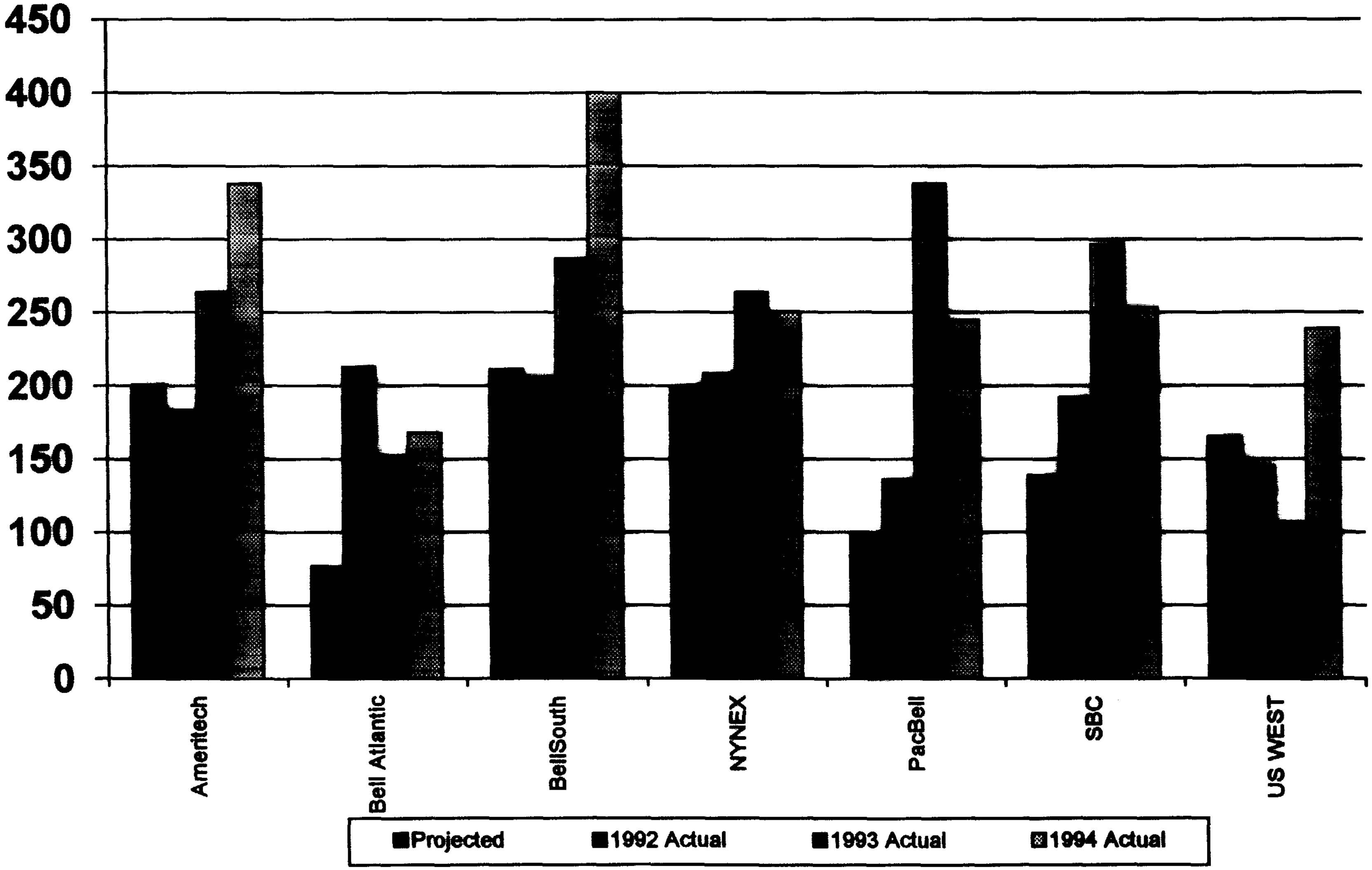
Source: 1994 Demand from 1995 Annual Access Filings
Ratemaking Demand from December 1992 Data Requests

Actual LIDB Queries vs. Ratemaking Quantities, Percent Under-forecasted



Source: Table 1

LIDB Query Demand - RBOC Projections vs. Actuals (M)



Source: Table 1, and 1993-1995 Annual Access Filings